

WASHINGTON STATE DEPARTMENT OF REVENUE

SPECIAL NOTICE

For further information contact:
Telephone Information Center
1-800-647-7706 or (360) 486-2345

Alternate Formats (360) 486-2342
Teletype 1-800-451-7985

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Taxation of Computer Software Services and Canned Software Sales or Licensing

New legislation, Engrossed Substitute Senate Bill 6470 (Chapter 332, Laws of 1998), changes the taxation of software sales and services related to software. This new act clarifies which activities are taxable as retail sales and which are taxable as professional services, and provides definitions of computer software terms for tax purposes. Effective July 1, 1998, software sales and software services are taxed as follows:

Canned Software Sales

The sale, lease or licensing of canned software is treated in the same manner as a sale or lease of a product, even though produced through a computer system or process. Sales of canned software to consumers (end users) are subject to the business and occupation (B&O) tax under the retailing classification. In addition, the seller must collect retail sales tax on the selling price.

Sales of canned software to businesses that will resell the software (without intervening use) are wholesale sales subject to B&O tax under the wholesaling classification. The seller is required to obtain a resale certificate from the purchaser to document such sales.

Professional Services

Creating and distributing custom software and **customizing canned software** are taxable as professional services. Income from these professional services is subject to B&O tax under the service and other activities classification. Duplication of custom software for the same person, or by the same person for their own use, does not change the custom software to canned software.

This legislation also provides the following definitions:

1. "Canned software" means software that is created for sale to more than one person.
2. "Custom software" means software created for a single person.
3. "Customization of canned software" means any alteration, modification or development of applications using or incorporating canned computer software for a specific person. "Customization of canned

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software” includes individualized configuration of software to work with other software and computer hardware, but does not include routine installation. Customization of canned software does not change the underlying character or taxability of the original canned software.

4. “Master copies” of software means copies of software from which a software developer, author, inventor, publisher, licensor, sublicensor or distributor makes copies for sale or license.
5. “Retained rights” means any and all rights, including intellectual property rights such as those rights arising from copyrights, patents and trade secret laws, that are owned or are held under contract or license by a software developer, author, inventor, publisher, licensor, sublicensor or distributor.
6. “Software” means any information, program or routine, or any set of one or more programs, routines or collections of information used, or intended for use, to convey information that causes one or more computers or pieces of computer-related peripheral equipment, or any combination thereof, to perform a task or set of tasks. “Software” includes only those copies of such information, programs or routines